Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Petitions of Verizon Telephone Companies for Forbearance Pursuant to 47 U.S.C. § 160(c) in the Boston, New York, Philadelphia, Pittsburgh, Providence and Virginia Beach Metropolitan Statistical Areas	)))))	WC Docket No. 06-172

REPLY COMMENTS OF
PAETEC COMMUNICATIONS, INC. AND US LEC CORP.

PAETEC Communications, Inc. and US LEC Corp.[1] (collectively **"**PAETEC"), by their counsel, respectfully submit these Reply Comments in the above-captioned proceeding, opposing Verizon's Petitions for forbearance from its obligation to provision § 251(c)(3) loop and transport unbundled network elements ("UNEs") throughout the Boston, New York, Philadelphia, Pittsburgh, Providence and Virginia Beach Metropolitan Serving Areas ("Six MSAs"). As explained below, if Verizon's Petitions are granted, PAETEC is concerned that the monopoly rent prices paid by wholesale customers for Verizon's special access services will continue to increase.[2] Injury to the public interest will be twofold: 1) special access will cease as

[1] On behalf of itself and its operating subsidiaries: US LEC Communications, Inc. d/b/a PAETEC Business Services; US LEC of Alabama, Inc. d/b/a PAETEC Business Services; US LEC of Florida, Inc. d/b/a PAETEC Business Services; US LEC of Georgia, Inc. d/b/a PAETEC Business Services; US LEC of Maryland, Inc. d/b/a PAETEC Business Services; US LEC of North Carolina, Inc. d/b/a PAETEC Business Services; US LEC of Pennsylvania, Inc. d/b/a PAETEC Business Services; US LEC of South Carolina, Inc. d/b/a PAETEC Business Services; US LEC of Tennessee, Inc. d/b/a PAETEC Business Services; and US LEC of Virginia L.L.C. d/b/a PAETEC Business Services.

[2] This concern is borne out in the recent GAO report, cited by other opponents to the Petitions, in which the GAO determined that rates for special access services have increased where they are not regulated, thus demonstrating that the lack of facilities-based competitive alternatives results in unconstrained rates. GAO, Telecommunications - FCC Needs to Improve

an economical alternative for competitive carriers who rely, or hope to rely, on it as a wholesale input, and 2) end-user rates for high capacity wireline loop services will increase without constraint. For this reason, and the many others established by other opponents in this proceeding, the Commission should deny the Petitions.

I. INTRODUCTION

PAETEC is an integrated communications provider that offers broadband communications solutions, including data and voice services, software applications and network integration services, primarily to business and institutional customers. PAETEC's geographic service area covers the eastern United States as well as Illinois and California. The company concentrates on providing high-quality telecommunications, information and data applications, and related services to customers with demands that require DS1 levels or greater. Founded in 1998, PAETEC has grown into a successful and profitable company with over $1 billion in annual revenue on a pro forma basis. PAETEC's interest in this proceeding is directly related to the relief Verizon seeks as well as PAETEC's presence as a wireline competitor to Verizon in five of the metropolitan areas subject to Verizon's petitions.

PAETEC has a relatively conservative network planning strategy in which it does not establish a point of presence ("POP") or deploy facilities in an incumbent wireline carrier geographic serving area until there is a critical mass of customers ready to be served by the POP. That way, operational dollars are not needlessly expended by constructing facilities to an ILEC end office or tandem while waiting for customers to sign up for service. PAETEC's self-owned switches, in combination with leased transport and special access facilities, comprise a core network deployment strategy that requires minimal investment in UNE loops, UNE transport,

---

Its Ability to Monitor and Determine the Extent of Competition in Dedicated Access Services, GAO-07-80 at 12 (November 2006).

enhanced extended loops, or dark fiber. Instead, PAETEC relies on special access services for its loop plant until it becomes economical to self-provision the necessary facilities. (Undoubtedly, PAETEC is one of the carriers that Verizon has referenced as an example of competitors who successfully rely on special access services to compete.)[3]

In contrast to typical CLECs, which provide telecommunications service through unbundled network elements, commercial agreements, local resale, or through combination of UNEs and their own facilities, PAETEC relies on UNEs for only a small percentage of its loop and transport needs. Instead, PAETEC employs special access for most of its "last mile" connectivity. In order to reach its subscribers, PAETEC purchases DS1 and DS3 special access service from ILECs to connect the customer premises with the nearest PAETEC POP.

PAETEC pays the higher rates for special access circuits rather than TELRIC-based UNE rates for two reasons. First, PAETEC's experience shows that ILEC special access operations support systems and processes -- although burdened with ordering confusion, provisioning delays and maintenance failures in their own right -- are still better than the operations support systems and processes related to UNEs. Second, regulatory uncertainty regarding UNE availability (as amply demonstrated in a long line of proceedings) wreaks havoc with business plans and distracts from the actual operation of the business.

PAETEC's strategy has worked extremely well. Unlike many other competitive telecommunications carriers, PAETEC has never gone through a bankruptcy or financial reorganization, but has managed to grow successfully while honoring its commitments to all of its creditors and investors. As successful as PAETEC has been in the competitive

[3] *See*, *e.g.* New York Petition, Lew/Verses/Garzillo Decl. paras. 11, 12, 45; *see also Special Access Rates for Price Cap Local Exchange Carriers,* WC Docket No. 05-25, Verizon Comments, Lew Decl. at 23.

telecommunications marketplace, however, its network and the continued growth of its business is dependent on the availability of reasonably priced special access facilities. PAETEC leases these facilities almost exclusively from ILECs. Particularly after the recent spate of large wireline carrier mergers, there now remain very few competitive access alternatives to ILEC-provided services.

II. FORBEARANCE WILL ELIMINATE THE CONSTRAINING INFLUENCE OF TELRIC RATES ON SPECIAL ACCESS PRICING.

Many parties in this proceeding have commented that forbearance will eliminate UNEs in the Six Cities, forcing competitive carriers who rely on these UNEs either to build out their networks to the last mile (an unlikely scenario) or convert their UNEs to special access circuits. To the casual observer, this would seem to benefit greatly PAETEC, since it has a business model that can operate profitably under these conditions, whereas its UNE-based competitors may not. However, this is not quite the case.

Although PAETEC does not lease UNEs as a primary loop and transport source, it does rely on their availability to provide a market check on special access rates. One only needs to review special access rates in areas in which Phase II pricing flexibility has been granted to conclude that the absence of UNEs will result in grossly excessive special access rates. These prices, which are simply monopoly rents for bottleneck facilities, not only increase a CLEC’s cost of services (in many instances beyond the point of commercial viability), but they also result in higher prices paid to *all* carriers by the business telecommunications consumer, not just CLECs. While CLECs who purchase special access must pass on the increased cost to their customers, ILECs also are freer consequently to increase their own end-user rates in turn. The ripple effect on the American economy is substantial.

PAETEC and many other special access customers have already commented at length on the inability of the Commission's current rules to restrain BOC special access rates,[4] and PAETEC will not belabor the point here. Suffice it to say that Verizon has been carefree in its special access pricing ever since the Commission granted Verizon's request for Phase II pricing flexibility in the Six MSAs.[5] With no competitive pressure to restrain Verizon's special access rates, Verizon has raised its rates for DS1 and DS3 channel terminations and channel mileage.[6] For example, Verizon's special access pricing flexibility rates in these MSAs for a DS1 10-mile circuit are 20 to 30 percent higher than its (minimally) regulated price cap rates.[7] Most recently, Verizon's 2006 interstate special access accounting rate-of-return was 52 percent.[8] This return reflects Verizon's dominant market power; it far exceeds both the last authorized rate-of-return of 11.25%[9] for such services and the expected return that would be made if the wholesale market were fully competitive. Thus, the Commission's prediction that adequate competitive alternatives exist to constrain Verizon's anticompetitive pricing of special access has proven entirely inaccurate and the lack of competition leaves Verizon free to increase rates above competitive

[4] *See Special Access Rates for Price Cap Local Exchange Carriers*, WC Docket No. 05-25, Comments of PAETEC Communications, Inc. (June 13, 2005).

[5] Verizon has received Phase II pricing flexibility relief for channel mileage in all of the six MSAs at issue here. For channel terminations, Verizon has Phase II pricing relief in the Pittsburgh and Virginia Beach MSAs and Phase I relief in the remaining four MSAs. *Verizon Petition for Pricing Flexibility for Special Access and Dedicated Transport,* CCB/CPD Nos. 00-24 and 00-28, Memorandum Opinion and Order, 16 FCC Rcd 5884, 5885 (2001); *Petition of Verizon for Pricing Flexibility for Special Access and Dedicated Transport Services*, CCB/CPD File No. 01-27, Memorandum Opinion and Order, 17 FCC Rcd 5359 (2002).

[6] *See Special Access Rates for Price Cap Local Exchange Carriers*, WC Docket No. 05-25, Ad Hoc Telecommunications Users Committee Comments at 21, Attachment C at 1-4 (June 13, 2005). The analysis was performed based on a 10-mile circuit (either DS1 or DS3) since pricing flexibility was granted.

[7] *Id*.

[8] This is based on Verizon's own Automated Reporting Management Information System (ARMIS) data.

[9] *Special Access Rates for Price Cap Local Exchange Carriers*, WC Docket No. 05-25, Notice of Proposed Rulemaking, FCC 05-18 para. 60 (rel, Jan. 31, 2005).

levels.

Even with these supracompetitive rates, an imperfect and barely tolerable competitive environment for access services still exists. This is only due to the availability of high capacity UNEs and price caps on some special access services. In the apparent absence of a competitive market for access services, a reasonable substitute must exist in order to control what would otherwise be unfettered ILEC natural monopoly behavior. The availability of ILEC high capacity UNEs priced at TELRIC contributes to special access pricing stability simply because purchasers of special access retain the flexibility to migrate to UNE services if wholesale special access prices are increased. The economics of substitute goods availability are well known to competitive providers like PAETEC. However, without the countervailing influence of TELRIC-based UNEs or complementary government imposed price caps, special access rates in all likelihood will continue to increase significantly and, eventually, may no longer be affordable.

Where an ILEC has a monopoly over an upstream input needed by competitors in downstream markets, the ILEC has powerful incentives to engage in anticompetitive price and non-price discrimination in the provision of that input to competitors. Because Verizon continues to enjoy monopoly control over local loops and transport facilities in many locations, it would have every incentive once UNEs are eliminated to increase special access prices (or reduce available discounts), degrade service quality, and engage in other anticompetitive conduct that inhibits competitors in the local market.

In its Comments in the Triennial Review Proceeding, Time Warner Telecom (“TWTC”) related a real-life example of this. It described how, prior to the *USTA II* decision,[10] it had been making progress (albeit slowly) toward negotiating an agreement with SBC that would have

[10] *United States Telecom Ass’n v. FCC*, 359 F.3d 554 (D.C. Cir. 2004).

provided TWTC with slightly reduced special access pricing combined with modest performance commitments. After the release of the *USTA II* decision, however, SBC's proposed terms became significantly more onerous and discriminatory. SBC immediately rescinded its offer of limited flexibility on revenue commitments and, instead, actually increased TWTC’s overall termination penalties for non-compliance with the volume and term commitments contained in the draft agreement and refused to continue negotiations regarding performance benchmarks or penalties.[11] TWTC related similar problems with Qwest. After *USTA II*, Qwest significantly increased the month-to-month charges in its federal special access tariff.[12] Given these examples, there is every reason to believe that, if the Commission were to relieve Verizon of its obligation to offer § 251(c)(3) loop and transport facilities in the MSAs at issue, Verizon’s special access rates for DS1 and DS3 facilities in these areas would increase beyond their already inflated levels.[13]

The Commission has unequivocally demonstrated that it understands this dynamic. In the *TRRO,* it explained that, even assuming that some competitive LECs like PAETEC can profit by using special access to provide their services, “the availability of UNEs is itself a check on special access pricing, and [the] elimination of UNE availability to customers using tariffed alternatives might preclude competition using those tariffed services going forward. Specifically, without recourse to TELRIC-priced UNEs, carriers using special access could lose

[11] *Unbundled Access to Network Elements,* WC Docket No. 04-313, Time Warner Telecom Comments at 16 (Oct. 4, 2004).

[12] *Id.* at 17.

[13] Although, as Verizon states in its Petitions, the *Verizon/MCI Order* prohibits Verizon from raising its DS1 and DS3 special access rates for 30 months following the merger closing (*i.e.*, July 28, 2008), Verizon would likely increase its prices shortly after that time frame. *Application of Verizon Communications, Inc. and MCI, Inc.*, WC Docket No. 05-75, Memorandum Opinion and Order, 20 FCC Rcd 18433 *Appendix G,* Special Access Condition No. 5 (2005) (“*Verizon/MCI Order*”).

substantial bargaining power when negotiating special access rates."[14] It agreed with TWTC that "UNEs have unquestionably had a constraining influence on the incumbents' exercise of their power over special access price and service quality."[15] In the *Verizon/MCI Order*, the Commission reaffirmed this conclusion and stated that "regardless of whether competitors are able to negotiate significant discounts, where competitive duplication of the last-mile facility is not economic, competing carriers will be able to rely on high-capacity loop and transport UNEs priced at Total Element Incremental Cost (TELRIC) …."[16]

At least two RBOCs agree as well. In the Triennial Review proceeding, BellSouth explained that "[w]here [UNE-based] competition occurs, it is very likely that the ILECs will continue offering advantageous pricing arrangements in order to avoid handicapping their special access customers relative to UNE providers."[17] In the SBC - AT&T merger, the parties reiterated the Commission's finding verbatim, quoting the Commission's statement that "the availability of UNEs is itself a check on special access pricing."[18]

---

[14] *Unbundled Access to Network Elements*, WC Docket No. 04-313, Order On Remand, 20 FCC Rcd 2533 para. 65 (2005) (*"TRRO"*).

[15] *Id.*

[16] *Verizon/MCI Order* para. 43; *see also id.* para. 51 (explaining that "where UNEs are available, they provide an alternative for special access service and might serve to constrain, at least to some extent, special access price increases and other raising rivals' costs strategies.") (citing *TRRO* paras. 167-181 and 62-65).

[17] *Unbundled Access to Network Elements*, WC Docket No. 04-313, BellSouth Special Access *Ex Parte* Letter at 8 (Dec. 7, 2004).

[18] *SBC Communications Inc. and AT&T Corp. Applications for Approval of Transfer of Control*, WC Docket No. 05-65, Description of the Transaction, Public Interest Showing and Related Demonstrations at 105 & n.348 (Feb. 21, 2005).

III. CONCLUSION

Through their efforts over the years, the ILECs have already been successful in restricting the affordability and, therefore, practical availability of UNEs. Their latest strategy is to abuse Section 10 forbearance to further cement their monopoly control of the last mile to the customer premises. Elimination of TELRIC-based UNEs would undoubtedly increase special access pricing, undermining or destroying the ability to compete using tariffed alternatives, thereby frustrating the pro-competitive goals of the Act. Given Verizon's continued dominance in the special access market, PAETEC urges the Commission to refrain from any action that will permit special access rates to rise above their already inflated levels. It should accordingly deny the Petitions for Forbearance. If it does grant forbearance, however, even in the face of overwhelming reasons not to, then it is absolutely imperative that the Commission immediately address the issue of unrestrained special access pricing in proceedings already before it.

Respectfully submitted,

Andrew D. Lipman
Russell M. Blau
Harry N. Malone
BINGHAM MCCUTCHEN LLP
2020 K Street, N.W.
Washington, D.C. 20006
(202) 373-6000

Attorneys for
PAETEC Communications, Inc. and US LEC Corp.

Dated: April 18, 2007